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Kenneth Rust  
Director, Federal Regulatory Affairs

April 27, 1998

EX PARTE OR LATE FILED



**Ex Parte**

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
1919 M Street, N.W. - Room 222  
Washington, D.C. 20554

RECEIVED

APR 27 1998

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: **CC Docket No 96-262**

Dear Ms. Salas:

On Friday, April 24, Frank Gumper, Susanne Guyer, Ed Shakin, John Bosley, and I, representing Bell Atlantic, met with Jane Jackson, Rich Lerner, Tamara Preiss, Chris Barnekov, David Konuch, and Aaron Goldshmidt, of the Competitive Pricing Division regarding the item captioned above. Portions of the attached material were used during the presentation.

Any questions on this filing should be directed to me at either the address or the telephone number shown above.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ken. Rust".

Attachment

cc: Ms. J. Jackson  
Mr. R. Lerner  
Mr. C. Barnekov  
Mr. A. Goldshmidt  
Mr. D. Konuch  
Ms. T. Preiss

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# A NEW APPROACH TO PRICING FLEXIBILITY AND ACCESS REFORM



April 24, 1998

# Pricing Flexibility Principles and Public Policy Goals

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- Competitive market forces are superior to regulatory constraints in determining efficient levels of prices, investment and output
- As markets are opened to competition, it is essential that asymmetric regulatory requirements be removed
  - » regulatory intervention should only be used as a safeguard in less competitive markets
  - » X-Factor should be reduced to reflect the impact of competition
- The Commission must pursue a policy that rewards efficiency, not one that protects competitors
- Prices should reflect market conditions and cost causation
- Pricing flexibility framework should be adopted immediately as an industry-wide standard, rather than through a protracted, piece meal and costly waiver process

# Current Marketplace Conditions Accelerate the Need for Pricing Flexibility

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- The 1996 Telecommunications Act set the stage to fully open the local exchange and access markets to competition
- The Commission's subsequent orders implementing the Local Competition provisions, Access Reform and Universal Service further facilitated opening the markets
- State approved interconnection agreements have removed the remaining barriers to entry

# Pricing Flexibility

## A New Approach To Pricing Flexibility Is Required

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- Increased competition accelerates the ILECs' need for pricing flexibility
  - » availability of unbundled network elements (UNEs) enable market entry with minimal investment
  - » mergers, such as AT&T-TCG & MFS/Worldcom provide further capital resources to local competitors
- The restructuring of access rates has changed the pricing flexibility required by the ILECs

# Pricing Flexibility is Required Now

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- Pricing Flexibility Based on Competition
  - “Like all price regulation, the Commission’s price cap system is an imperfect substitute for actual competition. **LEC price cap regulation should continue only until competition emerges in the interstate access market.** [The price cap regulatory constraints] tend to become unnecessary or counterproductive as market forces become operational.” (CC 94-1, 2nd FNPRM, par. 21, 9/20/95)
  - “... the LECs [are] subject to pricing restrictions that do not effect their competitors. **Additional flexibility may be justified in the future as competition develops.**” (CC 91-141, Phase I, par. 94, 9/2/93)
  - “Certain ... access charge rules ... create incentives, in an environment in which competition is possible, for high-volume users to shift their traffic ... to the networks of providers that enter based on the existing cost/price relationship, but that may be less efficient suppliers..” (USPP Order, pars 44, 73, 5/4/95)

# Pricing Flexibility is Required Now

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## ● **Price Cap Performance Review** (CC 94-1, 5/21/97)

- » “... we asked for comment on the extent to which competition might affect productivity growth, and whether we should permit carriers to use different X-Factors in different parts of their service areas in which they face different levels of competition. We invited parties to discuss this issue in conjunction with the issues we raised in the Price Cap Fourth Further Notice.” (par. 156)
- » A number of price cap LECs suggest that we permit LECs to use a lower X-Factor once they meet certain competitive criteria. .... We plan to address these proposals in a subsequent Order in our Access Reform proceeding, where we will set out in detail our market-based approach to access reform. (par. 161)

# Pricing Flexibility is Required Now

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- **Access Reform NPRM** (CC 96-262, 12/24/96)

- » “.. we propose ... [to] implement regulatory reforms as [ILECs] demonstrate that their local markets have achieved pre-defined, specific transition points, or “competitive triggers.” (par. 162)
- » **We anticipate that at least some [ILECs] reasonably should be able to satisfy these conditions during 1997.”** (par. 163)
- » **“We propose to eliminate four significant regulatory constraints when an [ILEC] can demonstrate that it faces potential competition ... in specific geographic areas ... the prohibitions against geographic deaveraging ..., ... volume and term discounts ..., and contract tariffs and individual request for proposals and restraints on ... new, innovative access services.”** (par. 168)



# Bell Atlantic's Unique Competitive Conditions Require Additional Pricing Flexibility

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- Bell Atlantic Merger Commitments
  - » Provision of “shared transport” UNE
  - » Uniform interfaces to OSSs
  - » NRC installment payment plan
  - » UNE prices based on forward-looking economic cost studies
- Uniquely competitive markets
  - » 451 interconnection agreements, 328 approved
  - » >45,600 UNE loops and 267,300 resold lines in service
    - ~880,000 lines are estimated to be served by competitors
  - » 10.7B MOUs exchanged with competitors in 1997
    - more than annual amount of calls in the state of Vermont
    - 3.4B exchanged YTD 1998
  - » >298,000 interconnection trunks in service
  - » 481 collocation sites in service with another 327 under construction
  - » Entrenched, mature competitors, TCG in NYC since 1983

# Pricing Flexibility Principles and Benefits

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- An administratively simple process using objective, verifiable criteria is required
  - » With 163 LATAs in 50 states and multiple services offered in each, the FCC could be inundated with individual pricing flexibility requests
- Bell Atlantic process will provide:
  - » a comprehensive framework for streamlined case-by-case resolution of requests, and
  - » reduced administrative burdens for both the FCC and applicants

# Pricing Flexibility Principles

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- Decrease regulation as competition increases
  - » Allow deaveraged rates and targeted reductions as competition grows
  - » Reduce Price Cap X-Factor as competition grows
  - » Provide a clear path for removal of all price regulation

# Pricing Flexibility

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- Differences in characteristics of the markets for multiple services require different criteria, time frames and pricing flexibility
- Pricing flexibility should enable further alignment of rate structures with costs -- e.g., Access Reform (SLCs, PICCs, & Transport) vs. UNEs
  - Transport vs. switched access
  - Existing access services vs.
    - » Interexchange services,
    - » Corridor services,
    - » Directory Assistance services, and
    - » New services

# Pricing Flexibility

## Transport vs. Switched Access

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- The factors which foster growth of competition and competitive behavior in a market are fully developed in the ***special access transport*** market, particularly for high capacity transport services
  - » Substantial competition exists
    - CLECs/CAPs have installed significant fiber networks in primary and secondary markets and have collocated and interconnected with ILECs
- ***Special access*** customers are sophisticated users, primarily interexchange carriers and large business customers, with “buying power” which fosters competitive behavior and makes the market easier to penetrate

# Pricing Flexibility

## Transport vs. Switched Access

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- CLEC/CAP provided **special access** services are fully substitutable for ILEC provided special access, and can “stand alone”
- The Commission has acknowledged these industry conditions in establishing “collocation cross connects” as the standard for permitting pricing flexibility for **special access** services
- This standard demonstrates actual market presence and market coverage by competitive providers of **special access** services

# Pricing Flexibility

## Transport vs. Switched Access

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- CLECs/CAPs are actively competing for switched transport services, particularly switched entrance facilities
- Competition for switched Direct Trunked Transport is growing rapidly as CLECs/CAPs expand the use of collocation to interconnect their facilities with the ILEC's network
- Emerging competition for Tandem Switched Transport will accelerate with the implementation of the FCC's Access Reform Order

# Pricing Flexibility

## Transport vs. Switched Access

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- The factors which foster the growth of competition and competitive behavior in a market are rapidly developing in the ***switched access*** market
- ***Switched access*** competition depends in part on development of local exchange competition which is demonstrated by the:
  - » availability of number portability, CLEC Telephone Numbers (TNs) in service, interconnection, UNEs and the transport and termination of traffic



# Proposed Process For Pricing Flexibility

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- A three phase framework under which pricing flexibility increases with competition
- ILECs may seek flexibility for a service group by a self-defined market area no smaller than a LATA
  - » Competition will evolve differently for different services
    - Switched - multiline business vs. single line bus. & res.
    - Transport - Special Access, Direct Trunked Transport & Tandem Switched Transport
  - » The ILEC assumes the burden of proving the threshold for the criteria for the entire market area
    - larger areas require burden of showing for entire area
    - smaller areas require burden of multiple showings

# The Pricing Flexibility Proposal's Safeguards

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- Phase I provides flexibility for downward price deaveraging only
  - » No consumer rate increases in rural high cost areas
- Phase II provides limitations on the amount of upward price deaveraging
  - » Rural high cost consumers protected from unreasonable rate increases

# RFP Flexibility is Necessary to Meet End User Requirements

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- **End user** requirements should be a significant factor in considering the appropriate ILEC pricing flexibility
- **End user** requirements
  - » are not defined by LATA or even state boundaries
    - *end user business applications define requirements*
  - » Enterprise offers involving a wide mix of services are typically required
  - » Business end users are accustomed to bidding and buying services under contract rates
- **End user** business customers are frustrated with the strict interstate price regulation of the ILECs
  - » limits the ILECs ability to respond to the needs of business customers
  - » discourages competitors from putting their best deal on the table in competitive bids

# End User RFP Pricing Flexibility Requirement

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- The ***minimum RFP requirement*** to meet the **end user** needs in today's marketplace
  - » ILEC ability to respond to RFPs with contract price offers in competitive bidding situations
  - » Expedited FCC approval of the ILEC's contract tariff (maximum 14 day approval process)
  - » Ability to include **any** Interstate service, at any location the customer requires in an ILEC response to a competitive RFP
- For ILEC **end user** services bid in "pre Phase II" areas, the contract pricing offer would be contingent upon the **end user** customer receiving at least one other bona fide competitive offer
  - » **End user** customer self certification in the contract acceptance document

# Criteria For Transport Flexibility

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**Phase I** 100 DS1 equivalent collocated cross connects -- State Wide

**Phase II** competitors have demonstrated the capability to provide service to **25%** of the market area

- **Step 1:** Classify wire centers (WCs) as competitive or non-competitive.
  - » Special Access competitive WCs are where a competitor has collocated facilities, UNEs, or its own facilities in the geographic area served by the WC
  - » Switched Transport competitive WCs are where a competitor has collocated facilities
- **Step 2:** Calculate the % of ILEC demand in competitive WCs to the total ILEC demand in the market area

# Criteria For Transport Flexibility

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## **Phase III**

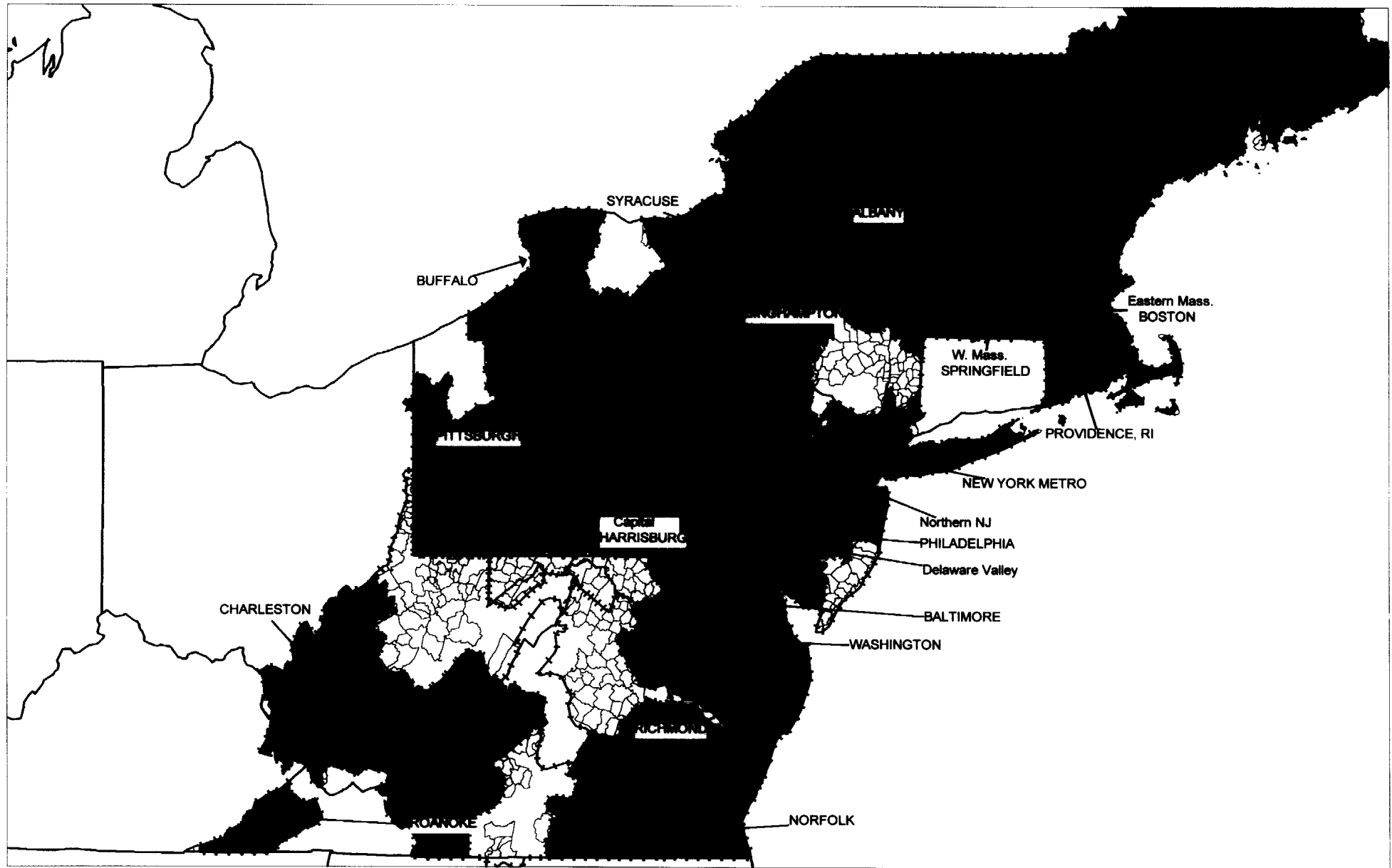
- » Competitors have demonstrated the capability to provide service to **75%** of market area
  - Use same steps as Phase II to determine that criteria are met

# Pricing Flexibility Granted Transport Markets

<b>Services</b>	<b><u>Phase I*</u></b>	<b><u>Phase II</u></b>	<b><u>Phase III</u></b>
<b>Special Access</b>	Growth option with V&T <i>Promotional offerings</i>	Respond to RFPs Increase upper service band limits to 10%	Services removed from Price Cap regulation
<b>Switched Transport</b>	Growth option with V&T Target TIC reductions to TIC in collocated WCs <i>Promotional offerings</i>	Respond to RFPs Increase upper service band limits to 10%	Services removed from Price Cap regulation

\* An expedited process should also be adopted to enable the ILECs to respond to the RFPs of end users due to competitive necessity.

# Special Access



LATA



Wire Center



Phase III



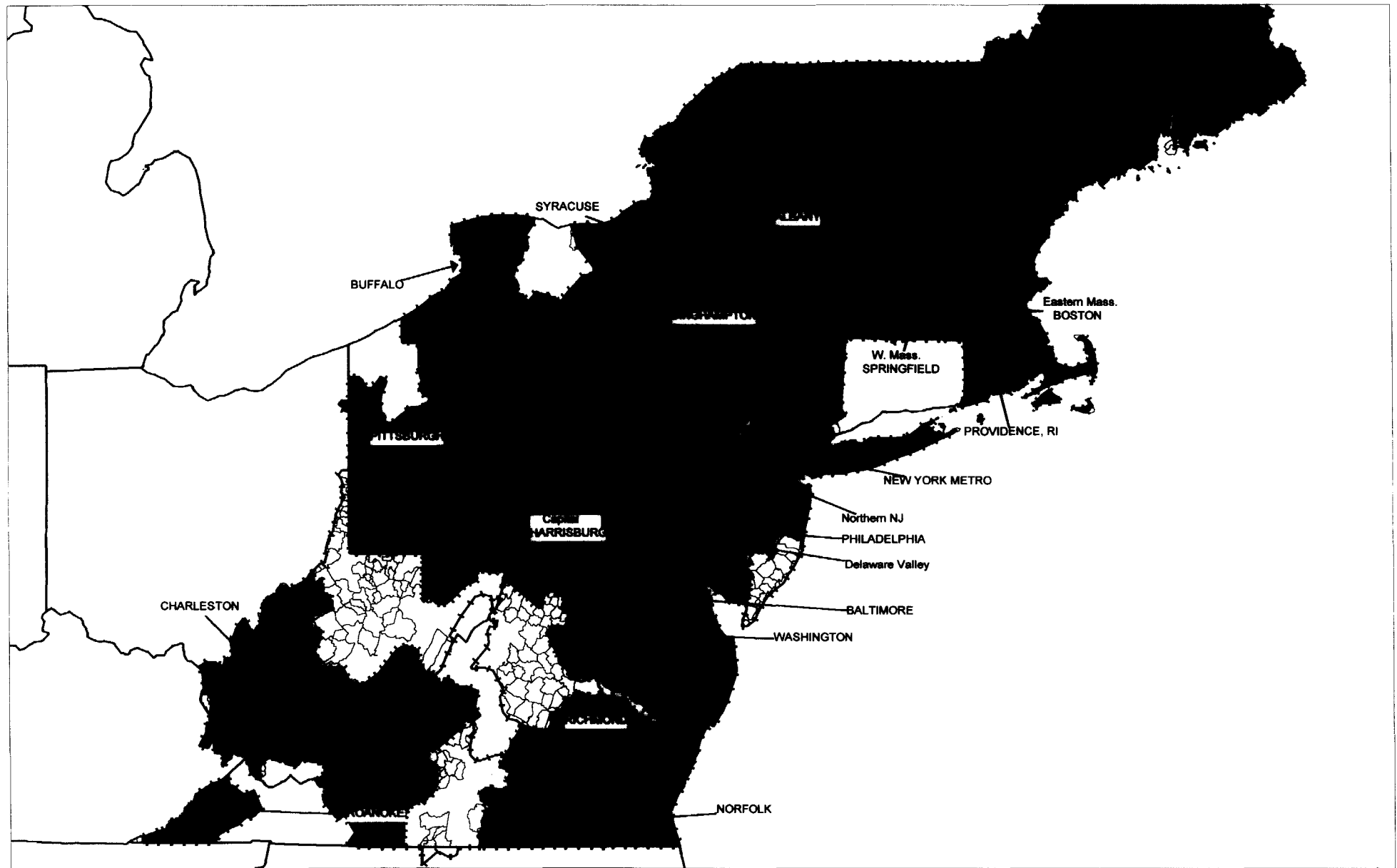
Phase II



Phase I, 0



# Switched Transport



LATA



Wire Center



Phase III



Phase II



Phase I, 0